



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
FURLONG ESTATE COMPANY)

Appearances:

For Appellant: Karl W. Krause, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax
Commissioner; Frank M. Keesling, Franchise
Tax Counsel; Clyde Bondeson, Senior Fran-
chise Tax Auditor

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protests of the Furlong Estate Company to his proposed assessments of additional tax in the amounts of \$121.87 and \$152.80 for the taxable years ended December 31, 1935, and December 31, 1936, respectively.

The Appellant is a California corporation with its principal place of business at Vernon, California. Its stockholders, who serve as its officers and directors are J. J. Furlong, T. J. Furlong, Annie M. Furlong and Judith M. Furlong Paxon, each of whom owns one share of its common stock. These individuals on September 24, 1931, executed a trust indenture in which they conveyed to the Appellant, as trustee, their respective one-fourth undivided interests in certain real estate located in the City of Vernon. Under the terms of the trust indenture the Appellant was empowered to collect the rents and income from the real estate, to execute new leases with respect thereto, to pay taxes, assessments and other necessary expenses incident to the management of the property and to pay the net proceeds in equal shares to four designated beneficiaries, the individuals above named, at such stated periods as appeared to the trustee or its officers to be for the best interest of all parties concerned. The Appellant was also authorized, subject to the written consent of a majority of the four beneficiaries, to mortgage, encumber, improve, sell or exchange any part of or all the real estate, the net proceeds of any cash sale to be divided equally among the four beneficiaries.

The Appellant does not engage in any activities other than those conducted pursuant to the trust indenture. It has no other property, receives no compensation for acting as trustee under the trust indenture, having, it claims no income whatever, and it has not, of course, paid any dividends. During the years ended December 31, 1934, and December 31, 1935, it received rentals from the real estate conveyed to it as trustee in the amounts of \$7,358.02 and \$7,666.20, respectively. The Commissio

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regarded these rentals as gross income of the Appellant, allowed as deductions therefrom certain amounts of interest, taxes and other expenses incurred in the management of the real estate and used the resulting net income as the measure of his proposed additional assessment. The propriety of this action of the Commissioner is the sole question presented by this appeal.

It is readily apparent from the facts involved herein that there would be very little, if any, real difference between the management of the real estate, the distribution of the net income therefrom and the interests, rights and obligations of the four individuals under the trust indenture and such management, distribution of income and interests, rights and obligations if the real estate were held by the Appellant free of the trust. Each of the individuals has a one-fourth interest in the corpus and income of the trust and owns a like proportion of the Appellant's outstanding capital stock. The income from the real estate is distributed to them under the trust indenture in exactly the same proportions as it would be distributed if the Appellant were the outright owner of the real estate. As to the determinations of the time of distribution of income and the amount of income to be distributed, it would appear to make little difference whether the determinations were made by the four individuals as the officers and directors of Appellant as trustee or by the individuals merely as officers and directors of Appellant if the property were owned by it. The consent of a majority of the beneficiaries required by the trust indenture for the encumbrance, improvement or sale of the real estate is precisely that which would be required on the part of those individuals as 'the officers and directors of Appellant. In fact, as respects all phases of the management of the real estate, there would be little if any, real difference between the activities of Appellant as trustee and, its activities as the owner of the property or between the activities of the four individuals as officers and directors of Appellant as trustee or as officers and directors of Appellant as the owner of the property.

The Commissioner, in our opinion, was fully justified in view of these facts in invoking the principle that the substance of transactions and not the form in which they may be carried out is controlling in the administration of income tax laws, United States v. Phellis (1921) 257 U. S. 156, Corliss v. Bowers (1930) 281 U. S. 376, Gregory v. Helvering (1935) 293 U. S. 465, S. A. MacQueen Company v. Commissioner of Internal Revenue (1933) 67 F. (2d) 857, Sanborn v. Commissioner of Internal Revenue (1937) 88 F. (2d) 134, Empire Trust Company v. Commissioner of Internal Revenue (1938) 94 F. (2d) 307, Hornblower v. Commissioner of Corporations and Taxation (1932) 278 Mass. 557, 180 N. E. 534. Under these authorities, the Commissioner was entitled to ascertain the nature of Appellant's business from the substance of the things done and not merely from the legal formalities in which that substance was cloaked. There was, accordingly, ample authority for his action in regarding the rentals from the real estate as the gross income of the Appellant.

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The Appellant contends that the Commissioner's position overlooks the fact that anyone of the beneficiaries could dispose of his or her stock, or any part thereof, in Appellant? while his or her interest under the trust indenture would remain the same, and that the points of similarity above mentioned would no longer exist if one of the beneficiaries were to sell or otherwise dispose of his or her stock. This contention is, however, of little significance⁴ In view of the facts that the only property owned by Appellant is that covered by the trust indenture, that Appellant has no activities other than the management of that property for which it receives no fees or commissions, and that it has no other source of income, the possibility of a separation of the stock ownership and the beneficial interests under the trust indenture would appear to be quite remote. The Appellant's principal argument is devoted to the proposition that its activities as trustee are not such as to constitute it an association within the meaning of the Federal Revenue Acts, which have defined the term "corporation" as including "associations." Inasmuch, however, as the Commissioner has not asserted a tax against the trust or the Appellant as trustee under the Massachusetts or Business Trust Act (Chapter 211, Statutes of 1933, as amended), but has rather regarded the rentals from the real estate as the gross income of the Appellant and, accordingly, levied his proposed additional tax under the Bank and Corporation Franchise Tax Act, it is unnecessary to pass upon this contention of Appellant.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protests of the Furlong Estate Company, a corporation, to proposed assessments of additional tax in the amounts of \$121.87 and \$152.80 for the taxable years ended December 31, 1935 and December 31, 1936, respectively, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

Done at Los Angeles, California, this 14th day of December, 1938, by the State Board of Equalization.

Richard E. Collins, Chairman
Wm. G. Bonelli, Member
Andrew J. Gallagher, Member

ATTEST: Dixwell L. Pierce, Secretary